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■ Bulletin #96 GST and residential properties

The goods and services tax (GST) imposed by Part IX of the *Excise Tax Act* (ETA) is a significant source of potential professional negligence claims. The application of GST to the construction and sale of residential properties in particular is complex and often misunderstood. The following is a very general summary of some of the more common GST problems relating to residential real estate. (All references below are to the ETA.)

New rental properties

Generally, where a builder [defined in s.123(1)] builds a residential complex [defined in s.123(1)] to be leased or rented to individuals as a place of residence (not for business purposes), the builder can claim input tax credits for GST incurred on construction costs.

But, when the complex is substantially completed and possession is given to the individual tenants, the builder must remit GST on the fair market value of the complex at that time [s.191]. This self-assessment is on a unit-by-unit basis for a condominium complex [s.191(1)] or based on the value of the entire complex for an apartment complex [s.191(3)].

Generally, there is no opportunity for the builder to recover GST paid under the self-assessment provisions of s.191 as an input tax credit or a rebate. But see *398722 Alberta Ltd. v. The Queen*, unreported, October 28, 1998, 97-1392(GST)G (T.C.C.), where a hotel builder was entitled to claim an input tax credit for a residential complex to which s.191 applied. The case is under appeal.

Leased land: national parks and Indian lands

The sale of new residential complexes (including residential condominiums) on leased land has created considerable uncertainty. Based on the present state of the law and Revenue Canada policy, *sales of new houses and condominiums in national parks and on Indian lands should not be treated as 'ordinary' sales of new residential housing* (i.e., subject to the same rules as properties outside these areas). It is not appropriate for a builder to sell the residential complex and charge, collect, and remit GST to Revenue Canada. If that is done, *double taxation* could be borne by the builder.

Because the underlying land in national parks and on Indian lands is considered to be subject to a lease, Revenue Canada has indicated that sales of new residential complexes (including condominiums) should be treated as follows:

1. On the sale of the complex to an individual purchaser, the builder should self-assess for GST based on the fair market value of the complex [s.191].
2. The builder should treat the sale to the individual as an exempt supply; that is, no GST should be charged to the purchaser. The builder should avoid phrases such as 'the purchase price includes all GST payable,' as this suggests that the sale is taxable and that the price includes an amount payable for GST.
3. A GST new housing rebate is available to the purchaser. However, the rebate is based only on the purchase price attributable to the building portion of the complex and not to the underlying land [s.254.1].

While Revenue Canada's policy in this area is well established and one case supports their views [*Taylor v. The Queen*, 98 G.T.C. 2206 (T.C.C.)], a number of cases are working their way through the Revenue Canada appeals process and the courts. Until they are finally resolved, it would be prudent for builders to seek an indemnity for all GST payable by builder or purchaser for the complex being sold.

Acreage properties

The resale of acreage properties is a source of exposure for vendors, purchasers, real estate agents, and counsel. The difficulty stems from the fact that a supply of an acreage property containing a residential complex may be treated as two separate supplies [s.136(2)].

A residential complex is defined in s.123(1), generally, to include the residential building and the land subjacent or immediately contiguous to the building that is attributable to the building and that is 'reasonably necessary for its use and enjoyment as a place of residence for individuals.' Generally, Revenue Canada takes the position that a maximum of 1/2 hectare qualifies for this allowance. See Revenue Canada *Policy P-069, Land Allowance for Residential Complexes*, dated May 25, 1993. There are circumstances where more than 1/2 hectare may be 'reasonably

necessary'; however, Revenue Canada tends to rigidly adhere to the 1/2 hectare policy.

While the sale of the residential complex together with the qualifying land is generally an exempt supply under ETA Schedule V, Part 1, s.2, the exigibility of GST on the remaining land must be *separately considered*.

Generally, the sale of the remaining land will be taxable unless the following conditions are satisfied [ETA Schedule V, Part 1, s.9]:

1. the vendor is an individual or a personal trust,
2. the land was not inventory to the vendor and was not used primarily in any business carried on by the vendor with a reasonable expectation of profit, and
3. the vendor did not subdivide the land in question. There are limited exceptions to this subdivision rule to allow
 - a) a 'one-off' subdivision into two parts,
 - b) a transfer to a related person for personal use and enjoyment, and
 - c) subdivision necessary for expropriation purposes.

If the remaining land was acquired and sold in the course of an 'adventure in the nature of trade' by a vendor that is an individual or a personal trust, the sale of the land will not be taxable unless the vendor filed, before the sale, a GST 22 election form. Essentially, this election form permits land acquired in the course of an 'adventure in the nature of trade' to be sold on a taxable basis.

Conclusion

Lawyers unfamiliar with the above rules should consult with an experienced GST practitioner before acting on behalf of their vendor or purchaser clients.

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■ Bulletin #97

Should you sit on your client's board of directors?

The supposed benefits of participating on a client's board of directors include being more informed about the client's business, being able to identify emerging problems and reach better solutions, solidifying the relationship with the client, and having other directors give weight to your opinion because you share their liability as a director. But rather than fostering confidence between lawyer and client, sitting on the client's board often leads to waivers of client confidentiality, conflicts of interest, exposure to increased risk of liability for you and your firm, and questions about your insurance coverage.

In the give and take of a board meeting, it's almost impossible for a lawyer-director to separate business judgements from legal advice and make that separation clear to other board members. Not only is the lawyer less effective as corporate counsel when it's unclear to the other board members just when legal advice is being given, but also this confusion of roles may result in an inadvertent waiver of client confidentiality. For instance, legal

advice may end up in the minutes of the board's meetings, or the lawyer as client-director may waive the solicitor-client privilege that belongs to the board.

The lawyer-director role can give rise to conflicts of interest or compromised professional independence. Some examples:

- the lawyer may be called upon to participate in board decisions that would affect the amount of work or fees going to the law firm
- in litigation the lawyer might find his or her own interests at odds with those of other directors who claim they relied on the advice of the lawyer as counsel
- the lawyer's fiduciary duty to shareholders as a director can conflict with his or her fiduciary duty as a legal advisor (e.g., solicitor-client privilege)
- the appearance of a conflict may trigger suits by shareholders, creditors, or regulators

Sitting on the board also increases the likelihood the lawyer will be named as a defendant or witness in litigation that challenges board decisions. The lawyer then may be disqualified and rob the company of its choice of counsel just when the company needs an informed lawyer most.

A lawyer who sits on a client's board is exposed to an increased risk of liability both individually and for the law firm. Lawyer-directors are held to a higher standard of care than either a non-lawyer director or a lawyer who is not on the board. That high risk of liability may cloud the lawyer-director's judgement and subordinate the lawyer's concern for the client's liability.

Should a claim arise, the unfortunate lawyer might find that he or she is without insurance coverage because there is an exclusion in the professional liability policy for acts done as a director and the directors and officers policy (if there is one) may limit coverage to acts done solely in the insured's capacity as a director.

The presumed benefits of sitting on a client's board of directors can be achieved without incurring the serious risks inherent in the dual role. A lawyer can offer to attend board meetings and receive all information distributed to board members in his or her capacity as solicitor rather than director, that is, as advisor rather than decision maker.

At a minimum, a lawyer must help clients understand and evaluate the serious risks in having their corporate lawyer serve on the board. Failure to do so might itself be the source of a malpractice claim.

Distributed with this issue:

- index for issues 1 through 24
- list of cases noted in issues 1 through 24
- reprint of a Y2K article by Anne E. Thar

Look for the *Loss Prevention Bulletin* on the web at www.lawsocietyalberta.com.